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IN THE

United States

Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Wm. H. Moore, Jr., Trustee in Bankruptcy for the Estate of Abe Silverstein,

Appellant,

vs.

Abe Silverstein,

Appellee.

BRIEF OF APPELLANT.

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BRIEF OF APPELLANT.

This is an appeal from an order entered by Honorable Wm. P. James, one of the judges of the District Court of the United States for the Southern District of California, overruling certain exceptions of the trustee filed to a report of James L. Irwin, referee in bankruptcy, sitting as special master, recommending the discharge of this bankrupt and granting a discharge to the bankrupt from his debts.

The bankrupt, Abe Silverstein, was engaged in business in the city of Los Angeles, up and until the spring of 1928, at which time an involuntary petition in bankruptcy was filed against him, based upon an assignment for the benefit of creditors made by him in the month of March, 1928. Prior to making this assignment for the benefit of creditors, the bankrupt had apparently borne a good

reputation in the credit field and had taken his discounts regularly.

Between the first of January, 1928, and the date of his assignment for the benefit of creditors in March, the bankrupt had entered upon a campaign of purchasing merchandise on credit until during a period of approximately two and a half months he had purchased $26,000.00 worth of merchandise from various wholesalers, of which $22,661.04 remained unpaid for. One of his brothers, Max Silverstein, during the month of March, 1928, opened negotiations with his creditors at the Los Angeles Wholesalers' Board of Trade seeking an extension of time for the bankrupt in the payment of his debts. This extension was refused and the bankrupt then executed an assignment for the benefit of creditors. His brother, Max, sought to purchase the merchandise back from the assignee for sixty cents on the dollar, which offer was refused, and he then attempted to purchase the merchandise at a higher price on credit, which was likewise refused. Creditors finally filed an involuntary petition in bankruptcy after making an investigation of the bankrupt's books, the bankrupt was duly adjudged a bankrupt, his stock and fixtures were sold to one Stein for $14,000.00, the total cash coming into the estate amounting to $14,167.00 as against indebtedness amounting to $22,661.04. When the bankrupt applied for his discharge, the trustee, pursuant to authority granted him at a meeting of creditors, filed specifications of objection to the bankrupt's discharge, based principally on a shortage over a period of three months amounting to $8,188.46, which was unexplained, and on the fact that the bankrupt had

prior to bankruptcy concealed or destroyed all of his cancelled checks, all of his check stubs, check books, bank statements and all original records pertaining to his banking transaction. He had turned over to his creditors a set of alleged books and records purporting to cover his business from the first of January, 1928, down to the date of his assignment. He had turned over to his trustee another set of double entry books, the entries of which overlapped the entries in the books kept by himself from January 1st to the date of his assignment, and an examination and a comparison of these two sets of books by a public accountant revealed a number of alleged falsifications in the books kept by the bankrupt. The public accountant's investigation also disclosed that between the first of January, 1928, and May 12, 1928, the bankrupt had wiped out a net worth of $5,012.80 and in addition thereto had incurred a deficit amounting to $3,157.66, making a total unexplained shortage of $8,188.46.

The specifications of objection were referred to referee James L. Irwin for hearing and report, and after trial a report was made to the court by the referee, sitting as special master, recommending that the bankrupt be granted a discharge. In view of the fact that the referee's report seemed to be based on the premise that an opposition to a discharge in bankruptcy was in the nature of a criminal proceeding, and that the bankrupt was entitled to the benefit of a reasonable doubt, the trustee filed exceptions to the master's report, which were overruled and the bankrupt's discharge granted, and an appeal is now being taken to this court.

ARGUMENT.

First Specification of Error.

It is our contention that the court erred in overruling the trustee's exception I to the master's findings which excepted to the master's second finding of fact, wherein the master found that it is not true that the bankrupt failed to explain satisfactorily losses of assets or deficiency of assets to meet his liabilities amounting to the sum of $8,188.46, or any other sum, occurring in his business between the first of January, 1928, and the 12th of May, 1928. This finding will be found in the record at page 9 and the exception will be found in the record at page 15. It is assigned as error on page 73 of the record under the heading, "First Assignment of Error." The shortage in question was based on the report of witness Samuel Namson, whose testimony appears in the record beginning at page 28. Mr. Namson's qualification as a public accountant was stipulated to by bankrupt's counsel and no question has arisen as to his competency and ability. Mr. Namson testified that he had examined the books and records of the bankrupt at the request of the Los Angeles Wholesalers' Board of Trade; that he was able to tell something about the financial condition of the bankrupt during the year 1927 and down to the time of the closing of his business in May, 1928. He said he could not get a statement because his checks were not there and the original books were kept only up until the end of February and the first of March. He also testified that Trustee's Exhibit I was a transcript of the original book for the first two months of the year

and that it was copied wrong. This book, Trustee's Exhibit I, was the book kept by the bankrupt. Trustee's Exhibit II was the book kept by the bookkeeper down to the time of his discharge. This examination disclosed a shortage, according to the witness Namson, of $8,188.46 between January 1, 1928, and May 12, 1928.

It is our contention that the testimony of this witness alone, based on the report which is in evidence in the record at page 29, together with the fact that the books were present in court at the time, established a complete case against the bankrupt until fully explained, and that the burden of proof under this exception thereupon shifted to the bankrupt.

Section 14 B 7 of the Bankruptcy Act as amended on May 27, 1926, reads as follows:

> "The judge shall hear the application for a discharge and such proofs and pleas as may be made in opposition thereto by the trustee or other parties in interest, at such time as will give the trustee or parties in interest a reasonable opportunity to be fully heard; and investigate the merits of the application and discharge the applicant unless he has (7) failed to explain satisfactorily any losses of assets or deficiency of assets to meet his liabilities; Provided, that if, upon the hearing of an objection to a discharge, the objector shall show to the satisfaction of the court that there are reasonable grounds for believing that the bankrupt has committed any of the acts which, under this paragraph (b), would prevent his discharge in bankruptcy, then the burden of proving that he has not committed any of such acts shall be upon the bankrupt."

As we said before, the testimony of Samuel Namson established definitely that this bankrupt had incurred a shortage or deficiency of assets amounting to $8,188.46 between January 1, 1928, and May 12, 1928, and that, standing undisputed, his discharge must be denied. The only attempt the bankrupt made to explain away this shortage was a naked statement to the effect that in taking the inventory on which the auditor's statement was based, the Board of Trade had depreciated the inventory and that there was actually much more merchandise on hand than was shown in the inventory used by the public accountant in making his audit. This charge was made by the bankrupt in the record at pages 46 and 47 after both sides had rested their case and the special master had announced an intention to recommend denial of the bankrupt's discharge on the ground that the checks had been destroyed and that there was a loss of $8,000.00 which had not been explained. So insistent was the bankrupt on this point that the master adjourned the hearing for the purpose of taking further testimony and at a resumption of the hearing, March 28, 1929, the men who took the inventory were brought into court and thoroughly examined regarding its correctness. The witnesses C. M. Carson, J. D. Kauffman and B. Palmer, who had taken the inventory, were examined by the trustee's attorney and all of them testified to the correctness of the inventory and a vigorous cross-examination by counsel for the bankrupt failed in any way to shake their testimony. So carefully was this inventory taken that when it was rechecked by the witness B. Palmer and the purchaser of the stock there was only a slight difference between the original inventory and the recheck-

ing amounting to ten or twelve dollars. [Testimony of B. Palmer, Record p. 59.] The trustee also put on another witness, B. A. Jacobs, the auctioneer who was employed to sell the stock, and his testimony was that it was sold at an auction attended by fifty or sixty people in bulk for a lump sum of $14,000.00. After being completely overwhelmed by this testimony, the bankrupt again resumed the stand and testified at page 63 that when he rechecked the inventory with one of the purchasers, he found that 19½ dozen B. V. D. union suits had been listed as 10½ dozen, and that 14 pairs of shoes had been omitted which were worth $3.90 per pair. He also claimed that the fixtures were listed in the total amount of $917.30 and that they had cost him about $1,300.00. This, so far as we have been able to find, constitutes the bankrupt's sole explanation of a shortage of over $8,000.00.

At the time of making the original charge that the Board of Trade had depreciated the inventory [Record p. 47] the bankrupt testified that the B. V. D.'s which had been overlooked amounted in value to $117.50 [Record p. 47]. The shoes which he claimed had been omitted, consisting of 14 pairs at $3.90 a pair, would be worth $54.60. The bankrupt therefore explained, giving him the benefit of any doubt on these two items, the sum of $172.10 out of a shortage of $8,188.46. As to the figure at which the fixtures were taken in, that will give him no comfort whatsoever, as the auditor in his report put the fixtures in at the bankrupt's own price $1,342.34. The record therefore stands with a shortage of $8,188.46 established in cold figures, with the bankrupt's only ex-

planation of this shortage being a charge that the Board of Trade adjusters, who had taken the inventory, had omitted $172.10 worth of stock. The master in summing up at the conclusion of the case accepted the inventory taken by the Board of Trade adjusters as correct.

It is our contention that the bankrupt absolutely failed to sustain the burden of proof imposed upon him by section 14 B 7 of the Bankruptcy Act; that the evidence of the trustee was clear cut, to the point and convincing. The bankrupt at page 43 of the record says:

> "I was waiting on the trade, and I went to work and made a book showing the balance in the bank, and I entered it as cash, a cash sale, and entered all the sales, and at the end of the month I added them all together, and I paid the creditors after that as much as I could, and I had to pay my help; and I had to use for my household, because I had a sick woman in the hospital and it took more money than it did before, and every dollar I took was on the book."

The special master seized on this casual reference to the fact that he had a sick woman in the hospital to speculatively justify this big shortage of over $8,000.00 over a period of four and one-half months. The master says [Record p. 69]:

> "He testified, I believe, that his wife had been in the hospital during this interim and that he had had considerable expense. It may be that some money was drawn out of the business to pay her hospital expenses, which he did not care to make a record of for fear of the effect it might have on his creditors."

Now we ask the court if this kind of sketchy testimony is sufficient to sustain a burden of proof in any kind of a case. Prior to the year 1926 so many abuses had arisen in connection with the Bankruptcy Act that Congress in its wisdom saw fit to enact an amendment to section 14 B for the purpose of making it more difficult for a bankrupt to obtain a discharge where there was any question of his honesty and integrity and business ability in the conduct of his business. Up to that time the burden of proof had been on the objecting creditor to the discharge of the bankrupt, throughout the entire proceeding, although there were some decisions to the effect that after the objector had established a *prima facie* case the burden shifted to the bankrupt. Congress seems to have seen fit to clarify the situation by a legislative enactment, the terms of which contain absolutely no ambiguousness. This enactment is open to no two constructions. It simply means that when the trustee had proved that the bankrupt has a shortage of assets, hitherto unexplained, that the burden of proof is then upon the bankrupt to show that he has not failed to explain it satisfactorily. Nowhere in this record is there any explanation in the world as to why a man engaged in business for a period of six years and who had carefully taken his discounts up to January 1, 1928, should suddenly buy $26,000.00 worth of merchandise on credit and land in the bankruptcy court with a shortage of assets in excess of $8,000.00 by May 12th of the same year. While it is our contention that the inventory taken by the Board of Trade adjusters was correct within ten or twelve dollars, we still contend that giving the bankrupt the full benefit of all the shortages that he showed in this inventory, he

had explained only $172.10 out of $8,188.46. As to the hospital testimony herein referred to, it means absolutely nothing. The bankrupt did not testify how long his wife had been in the hospital, whether she had been there for a day or a week or a month; he did not testify what the daily or weekly rate for her care amounted to; he did not testify what his doctor bills amounted to, nor anything else. The burden was not on the trustee to bring this out. It was on the bankrupt. This he failed to do, and it is our contention that the master erred in finding that he had not failed to explain this shortage, and the court erred in confirming such a finding.

As to the credibility of the witnesses, there can be no question. Mr. Namson is a public accountant; the witnesses Palmer, Carson and Jacobs had been with the Board of Trade for many years and no question was raised as to their integrity. We therefore contend that on this assignment of error sufficient grounds exist for the reversing of this order and the directing of the denial of a discharge to the bankrupt.

Second Assignment of Error.

In our opinion the second assignment of error is probably the most important of any of the ten assignments involved in this appeal. It involves a construction of one of the new amendments made to the Bankruptcy Act in 1926 which does not seem to have been authoritatively passed upon to date by any appellate court in this country. It is largely for the purpose of procuring an authoritative construction of section 14 B 2 of the Bankruptcy Act in this circuit that this appeal has been taken to this court.

Prior to the amendment of 1926, section 14 B 2 denied a discharge to a bankrupt who "with intent to conceal his financial condition destroyed, concealed or failed to keep books of account or records from which such condition might be ascertained." By the 1926 amendment Congress provided that a bankrupt would be denied a discharge who "destroyed, mutilated, falsified, concealed or failed to keep books of account or records from which his financial condition and business transactions might be ascertained; unless the court deems such failure or acts to have been justified under all the circumstances of the case." It will be noted that in amending this section Congress purposely omitted the words "with intent to conceal his financial condition," and added two more proscribed acts, namely, mutilation or falsification of books or records, also adding "from which his financial condition and business transactions might be ascertained." Any of these acts if committed by the bankrupt are now sufficient to bar his discharge unless the court deemed such failure or acts to have been justified under all of the facts and circumstances of the case.

It will be noted that Congress did not say "unless the court shall deem such acts to be *'excusable'* under the circumstances" (italics ours), but used the word "justified." We shall presently see that there is a wide difference between the meaning of the word "justified" and the word "excusable."

In the case at bar the trustee proved a number of damning facts and circumstances against this bankrupt.

First, that up to January 1, 1928, he had enjoyed a good line of credit and had taken his discounts promptly.

Second, that about January 1st, he suddenly began to fail and during a period when he was purchasing $26,000.00 worth of merchandise on credit he discharged his bookkeeper.

Third, that his bookkeeper up to the time of his discharge had kept a complete and accurate set of double entry books, but that the bankrupt opened an incomplete set of single entry books which he kept himself down to the time of his failure.

Fourth, that during the same month of February in which he discharged his bookkeeper, he destroyed or concealed all of his cancelled checks, check stubs and bank books. [Record p. 26.]

Fifth, that numerous entries had been made in the single entry books kept by him during the months of January and February which were false. [Record p. 31.]

Sixth, that no reason was advanced for the destruction or concealment of all of his bank records, cancelled checks and check stubs, except that it had always been his custom to do so.

Now, what justification can any merchant advance for such conduct as this? The testimony in this case shows that the bankrupt had been in business, dealing in gentlemen's furnishings and clothing, for a period of six years. He had started in on $3,000.00 borrowed capital. [Tr. p. 22.] During that time he had built up assets amounting to approximately $20,000.00. [Tr. p. 67.] At the time of his bankruptcy he was operating a business so large that it took a double store building to house it. [Tr. p. 44.] Right down to the very eve of his failure he had employed a competent bookkeeper and kept a

comprehensive set of books. Therefore, this bankrupt does not stand in the position of a man ignorant of the requirements of an American business man. Had he from the inception of his business career maintained a sloppy haphazard method of bookkeeping, the situation might be different, but in this case it is undisputed anywhere in the record that this bankrupt kept a set of first class books down to February, 1928.

As to the destruction of the checks, the bankrupt was wholly inconsistent throughout. Notice his various explanations offered for dumping his checks, check stubs, bank books, and bank statements in the garbage can almost on the eve of bankruptcy. Explanation No. 1 comes at page 24 of the record. The bankrupt says:

> "I kept my bank account with the Lincoln Heights Branch of the Citizens Trust & Savings Bank. I got my cancelled checks regularly.
>
> Q. It is a fact, is it not, that just before you went into bankruptcy, you destroyed all of your bank records, including your bank statements? A. No, sir; not just before. I had been for every month checking up and everything was entered in my books, then I destroyed them."

On page 25 of the record after the bankrupt admitted that he was unable to produce his cancelled checks and bank statements in court at that time, the special master asked him his reason for destroying them. The bankrupt answered:

> "A. I have done that all my life. There is no use in keeping them any longer after they are on the books. It is not necessary for me to keep them any longer then.

Q. You did not destroy them until February? A. No, it was far before that because everybody knows it and I don't keep no secret about it. Every wholesale man that came in knows it."

Counsel for the trustee then produced the transcript of the bankrupt's testimony taken at an examination under section 21 A of the Bankruptcy Act on June 5, 1928, and read it into the record, beginning at the top of page 26. Some of the pertinent questions that were asked on this examination showed the contradictory statements made by the bankrupt on June 5, 1928, at the time of his adjudication in bankruptcy, and other statements made by him later when he learned that a destruction of his checks would prove a serious obstacle to his discharge. Bearing in mind that at the hearing on the opposition to the discharge the bankrupt told the master that he had destroyed his checks far before February, note the following questions and answers as of June 5, 1928:

"Q. When did you destroy them? A. I don't know.

Q. Well, about when did you destroy them? A. They were there in February, I think."

Also please note that on June 5, 1928, immediately after the filing of the petition in bankruptcy against him this bankrupt was interrogated at a 21 A examination as to his reason for destroying his cancelled checks. What explanation did he have to offer at this time when his memory was fresh? Here are his answers at that time:

"Q. And you destroyed all of the cancelled checks? A. Yes, sir.

Q. And you destroyed your bank statements too? A. Yes, sir.

Q. What was the reason for destroying your books, statements and cancelled checks? A. No reason at all; I just destroyed them.

Q. And the stubs of your checks, too, you destroyed them? A. So long as I destroyed the checks, I destroyed the stubs.

Q. You knew you were losing money and running behind financially? A. Yes, sir." [Record p. 26.]

And again on page 27 of the record we find the bankrupt given a second opportunity at the time of his 21 A examination to explain his reason for the destruction of these original records showing what became of his money:

"Q. Can you tell the court the reason for destroying all the cancelled checks and check stubs? A. No reason whatever at all. I just destroyed them."

Farther down on page 27 of the record we find another "excuse" for the destruction of the records. The bankrupt says:

"I threw the checks in the garbage outside in the backyard and there was a man from Klein Norton's there at the time and there was nothing secret about it.

Q. What was your reason for destroying them? A. I have no room in my small space."

How inconsistent this explanation sounds coming from a bankrupt who testified at the middle of the same page (27) that he had two stores, and who later testified in the record, at page 44, that he had a double store. How foolish this sounds coming from a man who had store space enough to buy $26,000.00 worth of merchan-

dise on credit in three months' time, and yet didn't have space enough to keep his cancelled checks to show his creditors what became of the money he derived from the sale of their goods for which he had not paid. It is our contention that the destruction of all of these cancelled checks was not only unjustified, but not even excusable. It will be observed that there is no showing on the part of the bankrupt of any actual destruction of checks prior to February, 1928. It is true that he later testified that it had been his custom all of his life, but he cannot get away from the fact that at the time of his examination under section 21 A of the Bankruptcy Act on June 6, 1928, he testified that his checks were there in February. There is every indication of the preparation by this bankrupt for a fraudulent failure: $26,000.00 worth of merchandise purchased on credit in a period of three months; discharge of his bookkeeper at a time when he admits that he was in failing circumstances; keeping of two sets of books, one set of which contained numerous entries which were obvious falsifications, and at the time of the discharge of his bookkeeper destroying all of his cancelled checks.

Can this court conceive of a man in business for a period of six years being so foolish as to destroy all of the receipts that he had for paid invoices? Such destruction is indeed almost criminal. What safeguard would his trustee or his creditors have against the filing of fraudulent claims against his bankrupt estate? Supposing creditors who had been paid in full by the bankrupt's checks saw fit to file sworn proofs of claim for the amount of their paid invoices against this bankrupt estate, what proof would the trustee have that these invoices had been paid? Nothing except

the bankrupt's naked, unsupported statement to the effect that he had paid these invoices by check and had promptly destroyed the checks on their return from the bank. His story is so impossible as to tax the credulity of anyone, and we are completely at a loss to understand by what stretch of logic the master found that this bankrupt was justified in destroying these checks. It is a well settled principle that a mere custom will not excuse a violation of the law. The Bankruptcy Act imposes upon the bankrupt the duty of keeping proper books and records and turning them over to his trustee if he would be discharged from his debts. This, this bankrupt has utterly failed to do, and it is our contention that his discharge should be denied for that reason.

Although there seem to have been no decisions on this amendment, we can not refrain from passing on to the court the opinion of Professor Remington taken from the February, 1928, Supplement of Volume 7 of Remington on Bankruptcy, which discusses this amendment. It will be found at page 111 of the February, 1928, Supplement, section 3304, and reads in part as follows:

> "The Amendment of 1926 makes the bankrupt's destruction, mutilation, falsification, concealment or failure to keep books of account, or records from which his financial condition or business transactions might be ascertained, a bar to his discharge without other qualifications, and regardless of any specific intent, either an intent to conceal financial condition (always most difficult of proof) or any other intent, save and except what may be implied from the qualifying clause 'unless the court deem such failure or acts to have been justified, under all the circumstances of the case.'

"Such discretion, however, is, of course, a judicial discretion, and must be exercised in accordance with the principles and rules as may become established in the progress of time.

"What are to be those principles and rules the decisions of the court will establish. Meanwhile the following points are to be observed.

"1st. As to the failure to keep books of account or records the court must 'deem' the failure to keep them 'to have been justified,' not merely to have been excusable. One may excuse on the ground of ignorance or illiteracy, but the debtor is not to be justified in being in business life as a merchant, buying and selling on credit, with the moral duty imposed upon him of keeping his overhead expenses and personal withdrawals within the limits of his gross profits, if he is so ignorant that he does not know that moral duty, or so illiterate that he can not keep records that will enable him to ascertain his gross profits and overhead expenses and withdrawals. * * *

"Besides all this, the bankruptcy law is chiefly concerned with merchants and manufacturers doing business on credit; indeed, it was originally confined to traders, as we have seen in the introduction to this treatise; and the books of account of the merchant are the windows through which to ascertain his true financial condition. If he keeps correct books of account, both he and his creditors, alike, can quickly determine his financial condition and avert common disaster.

"And it is not to be forgotten that the Bankruptcy Act and bankruptcy courts are part of the educational system of our country, teaching right business principles and conduct; and they should not lower the standard of business conduct to the level of the ignorant and illiterate, but should raise the ignorant and

> illiterate to the right standard of business conduct. The lesson inculcated by the Amendment of 1926 as to the keeping of books of account and records is, then, that it is hazardous for one to try to be a merchant, and buy goods on credit for resale, in disregard of the duty to keep accounts. And it can seldom happen that such failure to keep them on the part of a merchant or manufacturer can be deemed 'justified' even 'under all the circumstances of the case.'"

Professor Remington then goes on to discuss the fact that destruction, mutilation, falsification or concealment of books or records denotes the volition of the bankrupt and that almost everyone of them implies evil intent.

We realize that textbooks on bankruptcy are not of the binding authority that attaches to judicial decisions, but Professor Remington, however, has treated this subject so logically that we cannot refrain from passing it on for the consideration of the court. There is no question and no dispute that after this bankrupt discharged his bookkeeper, he kept no books which in any way assisted the creditors in determining his financial condition or the cause of his failure, and we therefore contend that regardless of his intent, his discharge should be denied. An act which is justifiable, denotes an affirmative justification; an act which is merely excusable, denotes facts or circumstances which would exculpate a person from the performance of an otherwise unlawful act. In this case, however, we contend that there was neither justification nor excuse for this bankrupt's acts and that the master erred in recommending a discharge in the face of these facts, and that the court erred in confirming such recommendations.

Third Assignment of Error.

This assignment deals with exception III, to which the trustee excepted to finding IV of the master, in which the master found that it was not true that the bankrupt failed to keep books of account or records from which his financial condition or business transactions might be ascertained, and that it is not true that the bankrupt failed to keep books of account covering his receipts and disbursements subsequent to March 13, 1928, or at any other date. Extensive discussion of this assignment is unnecessary. Samuel Namson, the public accountant who examined the books, pointed out the following falsifications in the bankrupt's books at page 31 of the record.

January 4th, sale $36.53, raised to $281.98 by the bankrupt.

January 7th, sale $59.55, raised to $159.55 by the bankrupt.

January 12th, sale $68.14, raised to $168.14 by the bankrupt.

Total sales for January inflated to the extent of $481.98.

February 15, sales $48.42, raised to $148.12 by the bankrupt.

In addition to that Mr. Namson testified as follows, at the bottom of page 31 of the record:

> "It is impossible for me to ascertain without the bankrupt's cancelled checks what became of the bankrupt's money taken in in his store, because it would not be correct, because these books are kept only up until March 13th and when we add that it was of May 2nd here that they were running the business.

Since March we could not tell without any stubs or cancelled checks."

On cross-examination Mr. Namson was asked:

"Q. And up until March 13th, throughout all of his books there are entries there showing the amount of each deposit made in the bank, and the amount of each withdrawal from the bank; is not that true? A. No, it shows daily sales, merchandise received, general expenses, and paid bills, but there is no number of the checks, or checks, like you have in these old books; it only shows the amount paid."

Now what is there correct about the bookkeeping system of a bankrupt who kept two sets of books? One kept by his bookkeeper and one by himself. It is significant to note that in each of the falsifications made by the bankrupt in his own set of books he added exactly $100.00 per day to his daily sales, in every instance but one, in which he raised $36.53 to $281.98. This book, Exhibit I, in which these raised sales were recorded, was the book that he presented to his creditors at the time of the extension negotiations. He says at page 36 of the record:

"I was up there on that extension proposition. At that time I presented to the creditors and to the Los Angeles Wholesalers' Board of Trade this book, Trustee's Exhibit I, as being a true book of my business affairs."

There can be but one conclusion drawn from these facts. The bankrupt wanted more time to prepare for this failure and purposely padded his sales in a false set of books which he started on January 1st for the one purpose of presenting these books to his creditors showing inflated sales for the purpose of deceiving them into granting him

a further extension of time in the payment of his bills. We do not believe it is indulging in speculation to assume that the bankrupt never intended to turn over the bookkeeper's book, Exhibit II, until after the petition in involuntary bankruptcy was filed against him and it became necessary for him to surrender it to his trustee.

Fourth Assignment of Error.

This assignment deals with the exception filed to the master's finding of fact V, which completely exonerated the bankrupt on the charge of having falsified his books and records in contemplation of bankruptcy, by purposely inflating the sales just referred to in the foregoing assignment. Inasmuch as this angle of the case has been thoroughly discussed in the third assignment, we do not believe it will be necessary to further discuss this angle of the case.

Fifth and Sixth Assignments of Error.

The fifth and sixth assignments of error deal with the overruling of the exceptions filed to the master's conclusions of law numbered I and II. These conclusions of law were based on findings that the bankrupt had done nothing which would warrant a denial of his discharge, and, of course, if this court finds that the findings were erroneous and contrary to the evidence, the conclusions of law will necessarily fall with the findings.

Seventh, Eighth and Tenth Assignments of Error.

These three assignments deal with the District Court's error in confirming what we contend to be erroneous findings of fact and conclusions of law. We believe that the discussion of the ninth assignment of error will fully cover the seventh, eighth and tenth.

Ninth Assignment of Error.

The court will note from an examination of the record, and particularly from comments made by the special master throughout the proceedings, that the special master conducted this entire trial under the erroneous assumption that an opposition to a discharge was in the nature of a criminal proceeding and that the trustee was required to prove his case beyond all reasonable doubt. Laying aside this erroneous theory of the master's, there is no question in our mind but that the master would have found that the bankrupt had committed acts which would be a bar to his discharge and would have so recommended. On page 45 of the record, after both sides had rested, the master says:

> "Gentlemen, the Bankruptcy Act provides that the failure to keep certain books and records shall be grounds to deny the bankrupt's discharge, and the fact that these checks have all been religiously destroyed, and that there is a loss of approximately $8,000, is certainly not explained satisfactory.
>
> Mr. Getz: I want to go into that part of it.
>
> The Special Master: I certainly will have to find that he is not entitled to a discharge on that.
>
> Mr. Getz: That is on the set of books.
>
> The Special Master: That is what I am finding on."

After considerable discussion between counsel and the master, the master then learned that the estate would probably pay sixty cents on the dollar, or thereabouts, and he says:

> "I want to get a report from the trustee in this matter before proceeding any farther. The matter

> will be continued for a short time, and I will then take it up again."

After further testimony had been taken regarding the bankrupt's charge that the inventory had been depreciated by the Board of Trade and after the bankrupt had utterly failed to substantiate this charge, and after both sides had rested a second time, the master proceeded to announce his decision from the bench and after remarking on page 69 of the record that:

> "The estate will pay approximately sixty cents on the dollar after taking out the exemptions and expenses";

and after remarking at the bottom of page 69 that:

> "I do not believe the bankrupt has done anything improper, outside probably of destroying his checks, and his failure to keep a proper set of books,"

the master then proceeds to set out his theory of the burden of proof in an opposition to a discharge as follows:

> "I have always been inclined to hold that the hearing of objections to a bankrupt's discharge is in the nature of a criminal proceeding, and that the bankrupt is entitled to the benefit of a reasonable doubt. I am perfectly frank to say that there is doubt existing in my mind. I will find that the books of the bankrupt were improperly kept, from a bookkeeping standpoint, but there is apparently no fraud in the case, and I am going to recommend the bankrupt's discharge, by *resolving the doubt in his favor.*" (Italics ours.)

Section 14 B 7 of the Bankruptcy Act as amended in 1926 provides:

> "That if, upon the hearing of an objection to a discharge, the objector shall show to the satisfaction

of the court that there are reasonable grounds for believing that the bankrupt has committed any of the acts which, under this paragraph (b), would prevent his discharge in bankruptcy, then the burden of proving that he has not committed any of such acts shall be upon the bankrupt."

That the trustee had proven to the satisfaction of the court that there were reasonable grounds for believing that the bankrupt had committed several acts which would be a bar to his discharge is not disputed even by the master himself, because at page 45 of the record, after both sides had rested, the master announced that he "would certainly have to find that the bankrupt was not entitled to a discharge because of the fact that his checks had been religiously destroyed and there was a loss of approximately $8,000, which was not explained satisfactory." Why the sudden change of heart when the master figured out that the estate would pay out approximately sixty cents on the dollar? Is it necessary that a man go into bankruptcy and defraud his creditors one hundred cents on the dollar in order to be denied a discharge? What has a sixty per cent dividend to do with destruction of material records? And what has a sixty per cent dividend to do with an unexplained shortage of $8,000, which by the master's own admission was "not explained satisfactory"? Where is there any explanation subsequently in this record as to what became of the $8,000 that Mr. Namson found was short? The testimony of C. M. Carson, the first witness called on the reopening of the case, dealt only with the taking of the inventory and its correctness. The testimony of B. A. Jacobs dealt only with the selling of the stock at public auction. The testimony of B. Palmer and J. D.

Kauffman dealt only with the rechecking of the inventory which was found to be within twelve dollars of being correct. The testimony of Abe Silverstein, giving it the most favorable construction, accounted for about $174 of the $8,000 shortage, he pointing out an alleged shortage of 9½ dozen B. V. D.'s at $11.75 per dozen and 14 pairs of shoes at $3.90 a pair. Nowhere in this record was any attempt made to explain this huge shortage of $8,000, nor was any contradiction offered to the fact that this bankrupt had destroyed valuable and essential records pertaining to his business. Contrary to the theory of the master that it was necessary for the trustee to prove the bankrupt's guilt beyond a reasonable doubt, the burden was at this time on the bankrupt to prove his innocence by a fair preponderance of the evidence. Where is the proof?

The question of the degree of proof required of a trustee in bankruptcy in opposing a discharge has been before the courts repeatedly, and a careful search of the published opinions does not disclose a single opinion wherein an appellate court has held that proof must be beyond all reasonable doubt. In the Matter of Lewis N. Merritt, 28 Fed. (2nd) 679, 13 A. B. R. (N. S.) 47, decided in this court on October 22, 1928, Judge Gilbert said:

> "Objections to a discharge need not be proved beyond a reasonable doubt. A fair preponderance as in civil trials is sufficient. *In re* Garrity, 247 Fed. 310, 40 A. B. R. 664."

In the Matter of Doyle, 199 Fed. 247, 29 A. B. R. 102, United States District Court for the Western District of New York says:

> "No one would perhaps wish to convict the bankrupt of committing an offense punishable by imprison-

ment under section 29 of the Bankruptcy Act on such a showing, but, to bar a bankrupt's discharge, it is enough, I think, that the evidence by a fair preponderance establishes a fraudulent concealment, and proof thereof beyond a reasonable doubt is unnecessary."

In the Matter of Leslie, 119 Fed. 406, 9 A. B. R. 561, the court says:

"The main purpose of the bankrupt law is to prevent preferences, and secure a fair and equitable division of the bankrupt estate among the creditors, not to grant discharges. This end accomplished, the bankrupt is granted a discharge from all his debts. The attainment of the first is not to be sacrificed to the accomplishment of the last. If he willfully and fraudulently conceals any of his property from the trustee, he is not entitled to a discharge. The discharge is not denied as a penalty or a forfeiture because of the offense. The debtor has not performed one of the conditions precedent to obtaining a discharge from his debts. It is not necessary to establish this concealment of assets beyond a reasonable doubt, but by a fair preponderance of credible evidence only. The evidence must be satisfactory. Where the objecting creditors have made a *prima facie* case, the burden is on the bankrupt to so weaken it by credible evidence as to present a question of fact. Such is this case, and, when it was conclusively established that Leslie had this money after he filed his petition, and the trustee's account failed to show its receipt by him, it was incumbent on the bankrupt to show by credible evidence that he paid it over to the trustee. This has not been done. Courts are not compelled to accept the bald statements of interested witnesses, or of any witness when his statements are laden with inconsistencies, or burdened with inherent

improbabilities, or discredited by incriminating confessions."

In the case at bar the master says he has always been inclined to hold that the hearing of objections to a bankrupt's discharge is in the nature of a criminal proceeding. In the Leslie case, *supra*, from which we have just quoted, the court discussed the question as to what constituted a criminal case as distinguished from an opposition to a discharge in a bankruptcy proceeding. Among the various definitions given by the court for a criminal proceeding, we find the following:

"An action, suit, or cause instituted to secure conviction or punishment for a crime."

"Criminal cases are those which involve a list of injuries done to the Republic for the punishment of which the offender is prosecuted in the name of a whole people. Grimball v. Ross, 7 U. C. P. Charet 175."

Further discussion of this subject is unnecessary.

Conclusion.

We now arrive at the conclusion as to whether or not this bankrupt is entitled to a discharge in the face of all of these facts and whether or not the District Court erred in sustaining such findings of fact and conclusions of law as were made by the special master. We realize that in appealing a case of this kind, we are faced with a double burden, the master having found against us on the trial, and the district judge having confirmed his findings. However, this would not be the first time that a Circuit Court of Appeals has reversed an order granting a discharge where both the master and the district judge were in har-

mony and accord below. How such a decision as this could stand, we cannot comprehend. Every fact and circumstance in this case pointed unerringly toward the bankrupt's guilt and not one single fact or circumstance is reconcilable with his innocence. Let us resume briefly the facts on which we rely.

1st. The bankrupt's enviable credit reputation and the successful conduct of his business down to January 1, 1928.

2nd. A sudden change in the conduct of his business which reduced him from a high class credit risk taking his discounts, to a bankrupt in less than five months.

3rd. The purchasing of large quantities of merchandise amounting to $26,000.00 on credit between January and May.

4th. The discharge of his bookkeeper in February, 1928.

5th. The destruction of all of his bank records and cancelled checks in February, 1928.

6th. An attempt made after the discharge of his bookkeeper to duplicate back certain books and records between January and the date of his failure, and in duplicating them hundreds of dollars' worth of inflated sales appeared.

7th. A shortage in less than five months' time in excess of $8,000 and approximately $175 of this shortage explained.

8th. Conflicting stories as to why he destroyed his cancelled checks, his first explanation in June, 1928, being that he had no reason at all and his last explanation being that it had always been his custom.

9th. His utterly unwarranted and unfounded charge against the Los Angeles Wholesalers Board of Trade that they have purposely depreciated the inventory of his stock in an attempt to explain his $8,000 shortage, and his utter failure to substantiate his charge when given the opportunity to do so.

It is our contention that the referee recommended this bankrupt's discharge under an absolutely erroneous conception of the law. That he went on the reasonable doubt theory can not be doubted or disputed because he says so himself. It is significant that after both sides rested, the master was firmly convinced that this man's discharge should be denied, and that he did not feel otherwise about it until he learned that the estate would pay out approximately sixty cents on the dollar. He then took the attitude that the bankrupt should be given the benefit of a doubt existing in his mind. It is immaterial what dividends were paid in this proceeding. The mere fact that the creditors were vigilant enough to throw this debtor into the bankruptcy court before he had a chance to get away with all of his stock should not operate to penalize the creditors in seeking to prevent him from obtaining his discharge. In fact, that there was a shortage unexplained, alone, should prevent this bankrupt from obtaining the act of grace which he seeks at the hands of the court. Where that $8,000 went no one knows and the bankrupt has not explained it. Again quoting Judge Coxe, *In re* Becker, 106 Fed. 54, 5 A. B. R. 38:

> "A discharge is intended to relieve misfortune, but it must be misfortune coupled with absolute honesty. It is the reward which the law grants to the bankrupt

who brings his entire property into court and lays it without reservation at the feet of his creditors."

In re Merritt, *supra.*

We therefore respectfully submit that the judgment of the District Court should be reversed and the cause remanded with instructions to deny this bankrupt his discharge.

Respectfully submitted,

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